

BEFORE THE  
POSTAL RATE COMMISSION  
WASHINGTON, D.C. 20268-0001

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EXPERIMENTAL PRESORTED PRIORITY  
MAIL RATE CATEGORIES, 2001

Docket No. MC2001-1

RESPONSES OF UNITED STATES POSTAL SERVICE  
WITNESS SCHERER TO INTERROGATORIES OF  
THE ASSOCIATION OF PRIORITY MAIL USERS  
(APMU/USPS-T1- THROUGH T1-8)

The United States Postal Service hereby provides the responses of witness Scherer to the following interrogatories of the Association of Priority Mail Users filed on May 1, 2001: APMU/USPS-T1-1 through T1-8.

Each interrogatory is stated verbatim and is followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

Daniel J. Foucheaux, Jr.  
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May 11, 2001

RESPONSE OF POSTAL SERVICE WITNESS SCHERER  
TO APMU INTERROGATORIES

**APMU/USPS-T1-1.**

- a. Please confirm, based on your cost estimates, that for each tier of the proposed presort discounts (i.e., the ADC discount of 12 cents, the 3-digit discount of 16 cents, and the 5-digit discount of 25 cents), the pass-through would be 60 percent of estimated cost savings.
- b. If you cannot confirm, or if your answer is anything other than an unqualified affirmative, please explain in detail.

**RESPONSE:**

a. Confirmed, at each presort tier, the pass-through is *approximately* 60% of estimated cost savings.

b. The 60% pass-throughs are *approximate* due to rounding. Applying a 60% pass-through to the estimated cost savings at page 7 of Witness Levine's testimony, 11.6 cents for an ADC presort, 15.7 cents for a 3-digit presort, and 25.2 cents for a 5-digit presort were obtained. Consistent with base rates in the Priority Mail rate schedule, these discounts were rounded to the nearest cent, resulting in 12 cents for an ADC presort, 16 cents for a 3-digit presort, and 25 cents for a 5-digit presort. When these proposed discount levels are divided by Witness Levine's estimated cost savings, implied pass-throughs of 62.2% for an ADC presort, 61.3% for a 3-digit presort, and 59.5% for a 5-digit presort – all *approximately* equal to 60% – result.

RESPONSE OF POSTAL SERVICE WITNESS SCHERER  
TO APMU INTERROGATORIES

**APMU/USPS-T1-2.**

- a. At pages 8-10 of your testimony, you mention certain reasons for the conservative pass-through of cost savings your employ, but it is not clear why the particular percentage figure (i.e., 60 percent) was chosen. Please explain in detail why the Postal Service is proposing such a low percentage pass-through of the cost savings that would be realized by the presort preparations giving rise to the various discounts, including any calculations involved in making the pass-through recommendation.
- b. Did you consider any factors or contingencies that might cause the estimated cost savings to be even greater than projected? If so, please explain.

**RESPONSE:**

a. In proposing the 60% cost pass-through, I first evaluated the risk of not fully achieving the cost savings estimated in Witness Levine's testimony. In my judgment, several risk factors – identified at pages 8-10 of my testimony – warranted a relatively conservative pass-through. After consulting with postal management – and in particular getting their insight on cost pass-throughs proposed in other filings – I developed the notion that a pass-through in the range of 60-70% would be relatively conservative.

I chose the lower end of this range in order to minimize the effects of differing methodologies espoused by the Postal Rate Commission and the Postal Service for estimating the volume-variability of mail processing costs. As discussed at page 3 of the Request (see also footnote 2 on that page), Witness Levine's cost avoidance estimates assume the Commission's costing methodology. If the Postal Service's costing methodology had been used, cost savings would only have been about 57% of those estimated (please see USPS-T-2, Attachment E). The proposed 60% cost pass-through, by not greatly exceeding that 57% factor, drives a minimal wedge between the two competing costing methodologies.

RESPONSE OF POSTAL SERVICE WITNESS SCHERER  
TO APMU INTERROGATORIES

**Response to APMU/USPS-T1-2b.**

b. The risk factors identified at pages 8-10 of my testimony acknowledge the possibility that cost savings from the proposed Priority Mail presort discount could fall short of, *or could exceed*, Witness Levine's estimates. I only discussed the downside risk in my testimony because I wanted to try to avoid setting discounts that exceed the cost savings. I was not informed by Witness Levine of any other factors or contingencies that could cause cost savings to exceed his estimates.

RESPONSE OF POSTAL SERVICE WITNESS SCHERER  
TO APMU INTERROGATORIES

**APMU/USPS-T1-3.**

- a. If you had more confidence that cost savings you have estimated for the Priority Mail presort experiment are accurate, would you have proposed a higher percentage pass-through?
- b. Assume that the cost savings currently estimated for the Priority Mail presort experiment are accurate. (i) What percentage pass-through would you recommend? (ii) If less than 100 percent, please explain why.

**RESPONSE:**

a. I would have proposed a higher percentage pass-through if the risk of not realizing estimated cost savings had been lower. The presence of risk does not mean that the cost estimates are "inaccurate." It just means that there is a variance associated with their estimation.

b. Witness Levine's cost estimates apply to the Test Year (FY 2001). But over time, change is inevitable. Before the experiment is over, there will be changes in the way Priority Mail is handled and changes in other cost determinants that could have an effect on the cost savings realized from presorting. Indeed, reintegration of the PMPC network, which is underway, is a risk factor mentioned at page 10 of my testimony. With the possibility that cost savings from presorting could, over time, fall below current estimates, I would be hesitant to propose a 100% pass-through, even if I could be absolutely certain – in this hypothetical scenario – that the estimates are spot-on for Fiscal Year 2001. A pass-through less than 100% would guard against contribution leakage – and a shifting of the institutional cost burden to mailers not participating in the experiment – in the future.

RESPONSE OF POSTAL SERVICE WITNESS SCHERER  
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**APMU/USPS-T1-4.**

Please refer to your testimony starting at page 10, line 17, through page 11, line 3. You state that the proposed discount structure "will attract more mailer interest than...the old discount" and you "posit that, compared to the old presort discount, relative mailer interest in the proposed presort discount will double to 1.2 – 1.8 percent of total Priority Mail volume."

- a. On average, how many mailers used the old Priority Mail discount before it was discontinued?
- b. Is it your position that the volume from the 10 or so mailers who ultimately qualify to participate in the experiment will be double the volume of Priority Mail sent under the old (now discontinued) discount?
- c. Or is it your position that if the proposed discount were made available to all Priority Mail users, as was the old discount, the volume from the proposed discounts would result in a doubling? Please clarify whether you are talking about the volume arising solely from Phase I of the experiment, or the volume likely to arise either from Phase II of the experiment or from full implementation.
- d. If it is your opinion that the volume from those mailers who participate in the experiment will amount to 1.2 to 1.8 percent of total Priority Mail volume, what is your estimate of the percentage of Priority Mail that would take advantage of the presort discount if it were made available to all Priority Mail users?

**RESPONSE:**

a. As indicated in my response to OCA/USPS-T1-16, for Fiscal Year 1998, the last full year in which the old Priority Mail presort discount was in place, the CBCIS database shows 206 Priority Mail presort mailers mailing from 213 locations.

b. It is my position that the 10 or so mailers who ultimately qualify for Phase I of the proposed experiment will account for a doubling of *relative* volume compared to the old Priority Mail presort discount. Since total Priority Mail volume has grown since the old discount was eliminated, this implies more than a doubling of presort volume.

c. No, my estimate applies only to Phase I of the experiment. This was acknowledged at page 11, lines 9-11 of my testimony, and in line 18 on page 1 of Attachment A to my testimony.

RESPONSE OF POSTAL SERVICE WITNESS SCHERER  
TO APMU INTERROGATORIES

**Response to APMU/USPS-T1-4d**

d. I do not have an estimate for the Priority Mail volume that would be attracted to a presort discount available to all qualified mailers. That is one of the reasons for proposing an experiment: mailer interest can be gauged, and data necessary to file for a potential permanent classification – which would give all qualified Priority Mailers a presort option – can be collected.

**RESPONSE OF POSTAL SERVICE WITNESS SCHERER  
TO APMU INTERROGATORIES**

**APMU/USPS-T1-5.**

The minimum volume to qualify for the presort discount is 300 pieces per day (or 500 pounds), as stated in your testimony at page 3 line 2.

- a. Please confirm that a mailer that works 250 days a year and just qualifies for the discount will produce an annual volume of about 75,000 pieces.
- b. Please confirm that a mailer that works 250 days a year and has double the minimum required to qualify for the discount will produce an annual volume of about 150,000 pieces.

**RESPONSE:**

a. Not confirmed. My testimony at page 3, line 2 does not say "per day." The requirement of 300 pieces or 500 pounds is per mailing. It would not be necessary to present a mailing every day, so the referenced mailer would not have to produce annual volume of 75,000 pieces.

b. Not confirmed. My testimony at page 3, line 2 does not say "per day." The requirement of 300 pieces or 500 pounds is per mailing. It would not be necessary to present a mailing every day, so the referenced mailer would not have to produce annual volume of 150,000 pieces.



RESPONSE OF POSTAL SERVICE WITNESS SCHERER  
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**APMU/USPS-T1-6.**

Please confirm that if 10 participants in the experiment generate between 18.6 – 18.9 million pieces annually, then (i) on average each participant will produce about 1.9 million pieces, and (ii) a participant that generates about 1.9 million pieces annually will exceed the minimum requirement by approximately 25 times.

**RESPONSE:**

- (i) Confirmed.
- (ii) Not confirmed. The requirement of 300 pieces or 500 pounds is per mailing. The number of presorted pieces tendered per year will depend in part on the frequency of mailings, for which there is no requirement in the proposed Priority Mail presort discount. Thus there is no minimum annual volume requirement against which the 1.9 million pieces can be compared.

RESPONSE OF POSTAL SERVICE WITNESS SCHERER  
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**APMU/USPS-T1-7.**

Please refer to your testimony at page 4 line 6, which states that the Postal Service will seek participants of diverse size.

- a. What is the annual Priority Mail volume of the smallest participant expected to participate in the experiment?
- b. What is the annual Priority Mail volume of the second smallest participant expected to participate in the experiment?
- c. Please confirm that if some participants in the experiment have annual volume of less than 1 million pieces, and the average annual volume for all 10 participants is about 1.9 million, then some participants will necessarily have to have annual Priority Mail volume in excess of 2 million pieces.
- d. What is the Postal Service's best estimate of the number of Priority Mail users with annual volume in excess of 2.5 million?

**RESPONSE:**

- a. The minimum quantity requirement per mailing is 300 pieces or 500 pounds.

As stated at page 4, lines 9-13 of my testimony, "The Postal Service also has a preference for customers who....will present presorted mail on a regular or continuing basis, rather than infrequently or sporadically." I can therefore venture that the smallest participant in the proposed experiment will have presorted volume of at least several thousand pieces annually.

b. My expectations for annual presorted volume of the second smallest participant in the experiment are not materially different than the expectations for the smallest participant expressed in my response to part (a) above.

- c. Confirmed.

d. In Fiscal Year 1999, 6 customers (some mailing from more than one location) and 7 customer locations had Priority Mail volume in excess of 2.5 million pieces.

RESPONSE OF POSTAL SERVICE WITNESS SCHERER  
TO APMU INTERROGATORIES

**Response to APMU/USPS-T1-7d (Cont.)**

Several more customers and customer locations had volume just below 2.5 million, so the number with volume exceeding 2.5 million may have increased since FY 1999.

RESPONSE OF POSTAL SERVICE WITNESS SCHERER  
TO APMU INTERROGATORIES

**APMU/USPS-T1-8.**

During the last two years of the old presort discount (11 cents) for Priority Mail, what was the estimated pass-through of cost savings?

**RESPONSE:**

I am informed that the cost study accompanying the Docket No. R90-1 Priority Mail presort discount filing was not updated when the discount was increased to 11 cents per piece in Docket No. R94-1. In fact, there were no Priority Mail presort cost studies of any sort subsequent to Docket No. R90-1. Without cost knowledge for the last two years of the old presort discount, I am unable to say what kind of pass-through was implied by the 11-cent discount.

## DECLARATION

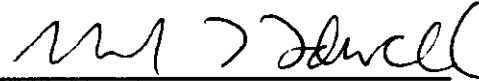
I, Thomas M. Scherer, hereby declare, under penalty of perjury, that the foregoing Postal Rate Commission Docket No. MC2001-1 interrogatory answers are true to the best of my information, knowledge and belief.

Thomas M. Scherer  
Thomas M. Scherer

5-11-01  
Date

## **CERTIFICATE OF SERVICE**

I hereby certify that I have this day served the foregoing document upon all participants of record in this proceeding in accordance with section 12 of the Rules of Practice.

A handwritten signature in black ink, appearing to read "Michael T. Tidwell", written over a horizontal line.

Michael T. Tidwell

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May 11, 2001